20 February 2018

The Board of Directors
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Dear Board of Directors

Viceroy open letter to Capitec

Thank you for your open invitation to address our questions. We believe our reports have clearly conveyed our concerns with Capitec, but have happily condensed our research into questions if that is your preference.

1. In the 12 months to August 2017, what was the actual value of loans that were cured out of arrears?

Capitec provides an *estimate* of cured arrears for the year ending August 2017 in its response to concerns raised by Benguela Global Fund Managers dated 1 February 2018:

(1) Estimate of cured arrears	
Arrears balances	
Aug-16	2,561
Feb-17	2,855
Aug-17	2,498
Average arrears	**2,638**
Cure rate (1-provision against arrears balances of 67.8%)	32.8%
Time to cure (months)	2
Months in year	12
Estimated arrears cured during the year	5,192

Figure 1 Extract from Capitec's response to Benguela Global Fund Mangers[1]

Capitec advises that a time-to-cure estimate of 2 months is "conservative" as the highest cure rates are observed on clients that are one month in arrears:

> model 32.8% of arrears balances cure. A rough estimate would be to take average arrears for the year, multiplied by the cure rate, multiplied by 12 and divided by the average period to cure (two months would be conservative, given that arrears are written off after month 3 and the highest cure rates are observed on clients that are one month in arrears). This would add a further R5.2 billion to the denominator for the period to

Figure 2 Extract from Capitec's response to Benguela Global Fund Mangers

Viceroy believe Capitec's definition of "conservative" in this case is misleading, as a shorter time to cure would imply a *much* higher value of loans that were in arrears over the course of the year. A sensitivity analysis of this figure is shown below:

[1] https://www.capitecbank.co.za/resources/Capitec_response_to_Benguela.pdf

Cured arrears sensitivity analysis			
ZAR (m)			
Aug-16	2,561	2,561	2,561
Feb-17	2,855	2,855	2,855
Aug-17	2,498	2,498	2,498
Average arrears	**2,638**	**2,638**	**2,638**
Cure rate	32.8%	32.8%	32.8%
Time to cure (months)	**2**	**1.5**	**1**
Months inyear	12	12	12
Estimated arrears cured during the year	**5,192**	**6,922**	**10,383**

Figure 3 Viceroy analysis – Capitec cured arrears

It is, frankly, unfathomable that a purportedly highly regulated financial institution must resort to providing estimates of its own financial data to begin with. It is more unbelievable that, when the integrity of Capitec's accounts is questioned, the disclosures become *less* transparent.

Arrears data should be easily accessible via management accounts collated by **adequate internal controls**, and *regularly* analyzed as part of risk maintenance within financial institutions (or any institutions, for that matter).

We ask you to please discard your estimates and present:

a. the actual value of cured arrears for the 12 months ending August 2017; and
b. the actual value of loans which fell into arrears during the 12 months ending August 2017

2. Do Capitec believe extending new loans to consumers who were only one day prior in arrears is both socially and financially sustainable?

Analysis of tens of thousands of Capitec borrowers' datasets within debt counselling firms show consumers were able to get new loans after paying down their arrears the day prior.

Capitec consumers constitute largely low-income, financially at-risk demographics.

Interviews with Capitec former staff depict the roundabout ways in which these consumers are able to temporarily cure their arrears in order to draw down a further, larger facility. This topic was covered extensively in our report dated 14 February 2018[2].

Does Capitec believe it is socially and financially sustainable to grow its loan book in this manner?

3. What amount of loans are made to clients who had cured arrears over the preceding month?

Following from Question 3 above, we can state empirically that the practice of extending new loans to clients were immediately prior in arrears is still occurring.

We contrast this with the lending criteria of a Standard Bank or Absa where there is a "cooling off" period before a borrower formerly in arrears can seek a new loan - to prevent exactly this behavior.

What amount of loans are made to clients who had cured arrears over the preceding month, week and day?

[2] https://viceroyresearch.org/2018/02/14/viceroy-responds-to-capitec/

4. Please elaborate on Capitec's recently amended maximum customer loans policy

Viceroy obtained a communication from Capitec Head Office to its branches, which details subsequent to our original report – and on the day of Capitec's response to Viceroy – Capitec appears to have amended the maximum number of loans consumers are entitled to:

8 February 2018

ALERT

Change to the Maximum Number of Credit Products per Client

Background

In our continuous drive to be the CEO in granting credit and to help our clients to bank better and live better, a change was made to the maximum number of term loans per client.

Note: The change is effective from **today, 8 February 2018**.

Amendments

Section 3.1.1 of the Branch Credit Granting policy (BCGP) was updated and now states:

- 3.1.1 The maximum number of credit products per client is limited to 5 which can include a maximum of 4 term loans (ranging from 2 to 84 months) plus a credit card facility or credit facility or 1 month loan.

Note: The updated BCGP document is available on the Credit Hub.

Branch action required

- Branch managers **must** ensure that all branch employees are aware of this communication
- If a client does not qualify for any credit, count the number of term loans **before** contacting Helpdesk or CAT
- System changes will be done in future to alert employees granting credit that the maximum number of term loans have been exceeded

Figure 4 Extract from Capitec branch communications

The direction of this limit amendment is unclear from Figure 4 above.

Capitec should disclose to its investors and borrowers why it has amended this policy while recently stating they have adequate risk policies in place. An amendment to the maximum number of loans issued, in either direction, will have a major impact on Capitec's risk profile and should be disclosed to the market.

If the maximum number of loans per customer has increased, we believe this will drastically increase the risk of Capitec's loan book and corroborates our thesis that overindebted customers finance existing loans by taking out fresh loans.

If the maximum number of loans per customer has decreased, this suggests Capitec are actively curbing the underlying risk of their underrepresented delinquencies and corroborating our thesis that the loan book is unsustainable. This outcome, in our opinion, would represent a prudent step in minimizing the financial damage caused by underrepresented loan book risk.

5. Branch-level internal controls

Following from Question 4 above, the last dot point on Figure 4 above states:

> *"System changes will be done in future to alert employees granting credit that the maximum number of term loans have been exceeded"*

Why did Capitec not previously have internal controls in place to enforce the maximum number of terms loans extended to a consumer?

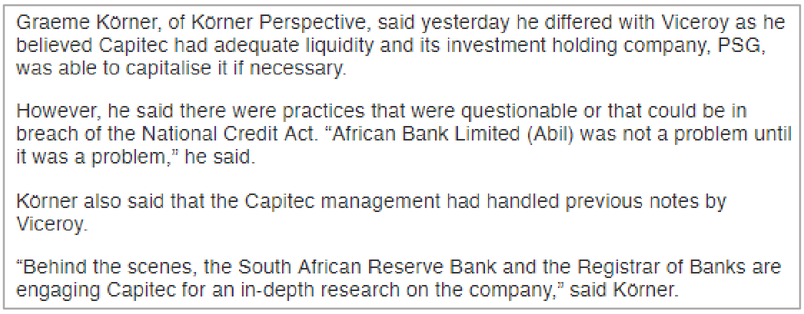
6. How many loan accounts, on average, do Capitec consumers have? How has this grown over time?

Analysis of tens of thousands of datasets from reputable debt counsellors show the number of Capitec loans per customer have increased ~50% over the last 2-3 years, despite a mostly flat market across competitors.

Can you please advise how many loans each Capitec customer has, on average, and how much this figure has grown over time since 2013 on quarterly basis?

7. Please advise which financial regulators are in discussions Capitec, if any, in relation to research prepared by Viceroy

Local investors have asserted through media outlets that Capitec are in discussions with the SARB in relation to the research compiled by Viceroy and possible breaches of the National Credit Act:



Graeme Körner, of Körner Perspective, said yesterday he differed with Viceroy as he believed Capitec had adequate liquidity and its investment holding company, PSG, was able to capitalise it if necessary.

However, he said there were practices that were questionable or that could be in breach of the National Credit Act. "African Bank Limited (Abil) was not a problem until it was a problem," he said.

Körner also said that the Capitec management had handled previous notes by Viceroy.

"Behind the scenes, the South African Reserve Bank and the Registrar of Banks are engaging Capitec for an in-depth research on the company," said Körner.

Figure 5 Extract from Independent Online – "Capitec will ignore Viceroy's latest broadside"[3]

Please confirm and deny the accuracy of these assertions, and please advise of any other financial regulators that are in discussions with Capitec, if any.

We look forward to your response.

Yours faithfully

Viceroy Research

[3] https://www.iol.co.za/business-report/companies/capitec-will-ignore-viceroys-latest-broadside-13294393

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